

## Prasarn Trairatvorakul: Growth, sustainability and inclusiveness – Thailand's key success factors

Dinner talk by Dr Prasarn Trairatvorakul, Governor of the Bank of Thailand, at the Japanese Chamber of Commerce (JCC), Bangkok, 23 March 2011.

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Ladies and Gentlemen,

Let me begin by extending my deepest condolence to the Japanese business community in Thailand on the immense losses caused by the unprecedented earthquake and tsunami in Japan. Despite the tragic incidents, I am confident that the strength and determination of Japanese people, together with supports from all around the world, will enable Japan to recover swiftly.

For today, I would like to thank the Japanese Chamber of Commerce for inviting me to share with the distinguished audience my assessment of the Thai economy. I also look forward to hearing your views and concerns regarding the economic prospects. Needless to say that Japan and Thailand have a long history of close economic relationship, with Japan being the top foreign investor in Thailand. As such, Thailand has become a production hub for several Japanese industries, including vehicles, electronics and electrical appliances. I therefore hope that our discussion today will help align understanding and further strengthen the partnership between our two economies.

For my presentation this evening, I would like to offer my assessment of the economy based on what I see as the three most important attributes that determine the economic progress for Thailand – the “key success factors”, if you will. **First is that growth must be sustainable.** We don't want three years of boom followed by three years of bust. **Second, the country's potential growth rate should be high enough to continuously raise the people's general standard of living.** And, **third, growth should maximize inclusiveness.** By this I refer to maximizing the exposure of everyone to economic development, both in terms of participation in the development process and in the sharing of its benefits. This would lessen the problem of inequality, and foster social harmony. That said, I wish to underscore that, even though growth is the most visible factor, growth alone is not sufficient but sustainability and inclusiveness are also crucial to ensure long-term economic success.

Looking at economic strengths and weaknesses in the context of these three success factors should provide for a better understanding of the role of central bank and policymakers in advancing the economic development agenda for Thailand. Indeed, these success factors entail three corresponding fundamental responsibilities for policymakers. The **first responsibility** is to ensure continued macroeconomic stability, which is a prerequisite for economic sustainability, by gearing our economy towards operating at the potential level. **Second** is to raise the people's standard of living by expanding the potential growth rate of the economy. **Third**, to maximize inclusiveness, we have to ensure the equal exposure to economic opportunities for all.

Ladies and Gentlemen,

**Let me start with the first success factor, namely economic sustainability, which I consider to be Thailand's most important strength.** After the 1997 crisis, Thailand has no longer experienced the current account deficit problem. Inflation averaged 2.6 percent over the past decade, or about half of the 5.1 percent average rate during the 1990s prior to the

Asian Crisis<sup>1</sup>. Meanwhile, our unemployment rate has been low at around 1 percent. The banking sector, severely affected by the 1997 crisis, has been safe and sound, minimally affected by the global financial crisis ten years later as a result of strengthened risk management and governance. Despite ongoing net capital inflows into Thailand, there appears no sign of asset price bubble while the degrees of leverage in the corporate and household sector are still low. Overall, I believe that the Thai economic stability has strengthened continuously. This achievement has been attributable to sound fiscal and monetary policy, together with appropriate and market-friendly regulations, aimed at keeping the economy operating close to its potential.

Suffice it to say that the Bank of Thailand has fulfilled our responsibility to help achieve the economic stability. Under the inflation-targeting framework, the policy interest rate is the main instrument used to influence saving and spending in the economy so that demand matches potential supply. This economic balance has, in turn, produced a low and stable inflation environment necessary for the sustainable growth. In addition to the interest rate tool, the central bank also has regulatory tools to prevent undesirable accumulation of financial imbalances. Indeed, the so-called “macro-prudential policy” has been used as a complementary policy tool to the interest rate policy long before the sub-prime crisis. To give you a few examples, the Bank of Thailand has imposed a cap on loan-to-value ratio on high-end real estate loans since 2003. We also tightened credit card and personal loan regulations in 2004 and 2005, respectively. These pre-emptive measures helped reduce balance sheet vulnerability and ensure Thailand’s resiliency against and fast recovery after the sub-prime crisis. Nevertheless, despite the success so far on the stability front, we cannot afford to be complacent about economic stability as shocks can occur at any time and in any form, thus we must remain vigilant.

Ladies and Gentlemen,

Economic stability is the means to an end but not an end in itself. This is because we can also have a stable economy that grows at an undesirably low rate, especially when productivity is sluggish. This brings me to **the second success factor**, namely high potential growth. **Thailand, despite its strength in economic sustainability, has a moderate potential growth rate compared to her peers.** Over the past decade, our GDP grew on average by 4.4 percent<sup>2</sup> annually, and the average growth rate rises to 5.1 percent excluding the sub-prime crisis period. This growth performance has been somewhat lower than the Bank of Thailand’s research result<sup>3</sup>, which estimated Thailand’s potential growth at up to 6.1 percent for the next decade. Our estimate result is based on the assumption that the country’s investment growth over the next 5 years returns to its normal trend, which is approximately 10 to 12 percent growth per year as seen during 2002–2005. But, as you are aware, the current growth rate of investment has been around 9 percent, and this makes investment promotion a very challenging and important policy agenda going forward.

My own assessment is that this policy challenge can be achieved by strengthened fiscal policy efforts as public investment has been progressing in recent years. **Infrastructure projects, which have been long delayed due to political problems, are now back on track.** The construction of airport rail link came to a completion last year. Two more railway routes under the plan of Bangkok Mass Transit System are presently under construction. Several other railway projects in other regions other than Mass Transit in Bangkok are also in

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<sup>1</sup> Inflation rate of 2.6 percent is the average rate during 2001–2010 while 5.1 percent is the average rate during 1990–1996.

<sup>2</sup> Average GDP growth rate during 2001–2010.

<sup>3</sup> Chuenchoksan, S. and Nakornthab, D. (2008). “Past, Present, and Prospects for Thailand’s Growth: A Labor Market Perspective,” Discussion paper. Bank of Thailand.

the pipeline. These public investments are welcomed steps towards further infrastructure developments, which will help lower logistic costs and boost Thailand's productivity.

In my view, public investment can and must do more to lower production costs and crowd in private investment over the medium term. Having said that, ***the physical infrastructure must be complemented by human capital development, to enhance productivity and potential growth.*** Over the past decade, the government has continuously worked to improve the country's education and health care systems. There have been extensions in terms of years of compulsory education and more financial supports to increase access to higher education. Subsidized health care for the poor has been provided with extending coverage over the years. Although the public spending (as percentage of GDP) on education and health care in Thailand is comparable to its neighboring countries, the quality remains relatively low. This is evident in the cross-country comparisons of the ratio of those attending secondary schools as well as the relatively low life span, especially compared with Japan which has the longest life span<sup>4</sup>. ***Hence, in moving towards a higher labor-skilled economy, Thailand needs to further improve access as well as quality of education and health care to enhance the quality of our human capital.***

Distinguished Audience,

Apart from strengthening infrastructure investment and human capital investment, the ***exchange rate also plays an important role in influencing Thailand's productivity in the long-run insofar as it affects efficient resource allocation in the economy.*** Given the recent development of the global economy, many of you will agree that Thai baht is unlikely to go back to the level seen in the pre-2006 era. This structural change has two implications; first, uncompetitive export sectors will be the most challenged. Second, the strong baht is an opportunity for Thailand to increase productivity through higher imported-capital investments.

The first implication should not be of excessive concern as long as the unemployment rate remains low, which is the case for Thailand. This is because ***the market mechanism will allow efficient adjustment as uncompetitive firms have to either upgrade themselves, or close down and free up labor resources to more competitive firms.*** This reallocation process implies that the country makes a better use of labor resources and should therefore yield higher productivity. At present, Thailand's unemployment rate hovers steadily around 1 percent despite strong baht appreciation in recent years. In the meantime, export growth has remained robust with a swift recovery from the global crisis. These developments possibly indicate that our export sectors have adjusted themselves well and labor resources are being allocated more efficiently. In line with this view, the baht appreciation has somewhat catalyzed the adjustment of Thai economy to a more efficient use of labor resources.

In fact, Thailand has continued to face a shortage of labor supply and has to employ immigrant workers from neighboring countries. This tight labor market phenomenon creates incentive for firms to shift factor of production from labor to capital. This shortage of labor will then accentuate my second implication of a strong baht, since ***the shortage of labor, in addition to cheaper capital goods in baht term, gives incentive for investors to make imported-capital investments.*** This is the part where the private sector role is essential, especially as Thailand has benefited from immense foreign direct investment in which Japan played the top role.

Ladies and Gentlemen,

Let me now turn to the ***last success factor: inclusiveness***, which is probably the weakest achievement among the three success factors so far. However, inclusiveness is something that has increasingly gained attention from Thai policymakers in recent years, as it was part

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<sup>4</sup> IMD, 2010.

of the root cause of political unrest. ***I believe that inclusiveness will be one of the long-term solutions for Thailand political stability. Yet, I should stress that inclusiveness has a different concept from equality. It focuses on creating equal opportunity rather than equalizing income.*** Income equality ultimately means that the reward system is independent of performance which erodes efficiency. Inclusiveness, on the other hand, refers to having equal opportunity which still preserves efficiency through reward incentive system while allowing the rich and the poor to have the same economic opportunity. As such, inclusiveness refers to equal access to public infrastructure such as education, fair competition and equal treatments of law and regulation to all. In this way, inclusiveness will provide equal exposure to yield the benefits from economic prosperity.

Improving inclusiveness in Thailand will be a long process but some initiatives have already been put in place. These include decentralization of public spending, better access to education, informal sector debt alleviation, and better credit access for low income group. While these initiatives bode well for inclusiveness, the government must be careful not to excessively gear government spending towards populist policies that eventually add financial burden to the already-tight budget and sovereign debt in the future. In particular, it is important that the government prioritize and balance between public consumption and public investment accordingly. More importantly, efficient management with good governance will be the key ingredients to policy success in this regard.

***For our part, the Bank of Thailand has also put inclusiveness as one of the main agenda in the Financial Master Plan II***, other than efficiency and provision of financial infrastructure. ***The objective is to provide financial access for all, particularly to the underserved***, in an efficient and financially viable manner ***without compromising financial stability and prudence***. This is still an on-going process which we are committed to.

Ladies and Gentlemen,

Before ending my talk this evening, I would like to address some of the concerns raised by Japanese corporations in Thailand, as reported in a survey from JETRO (Japan External Trade Organization). ***The key concerns include political stability, development of customs-related system and human resource development.***

On politics, I have good faith that the upcoming election is another important step towards ***political stability***, while commitment to improving inclusiveness mentioned earlier would bring a long-term solution to the country. As for the ***customs system***, Thailand has continued to improve the customs system over the past five year as attested by the improvement in indicators of *trade across borders*, which is a category in *Ease of Doing Business* assessment, done by the International Finance Corporation (IFC). Export-related requirements in terms of number of documents or period of procedure have been reduced or shortened over time. These improvements and further works will certainly help promote efficiency in international trades.

With regards to the issue of ***human resources***, I see that the reliance on migrant labour to fill the current labour shortage is not a long-term viable solution for Thailand. In fact, the economy, with joint efforts of private and public sectors, needs to raise labour productivity by upgrading production technology that uses higher skilled labour.

Finally, let me close by stressing that the three success factors: ***growth, sustainability and inclusiveness are necessary and complementary to achieving long-term economic progress for Thailand.*** For the central bank's part, many of the issues discussed this evening are beyond the functional scope of the Bank of Thailand. Our main role is to ensure sustainable growth by maintaining macroeconomic stability through appropriate monetary policy and financial regulations. For this, I can assure you that we are fully committed to our role and responsibility. As for broader national economic policy agenda, public policies aimed at improving the country's productivity are necessary, but they alone are not sufficient to raise Thailand's potential growth rate; ***your contribution from the private sector will be the key to the eventual success.*** And, I am convinced that working together to achieve our

common goals will strengthen our long history of economic partnership and brings economic prosperity to both Japan and Thailand.

Thank you.